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SUBJECT: GoA Repeals Export Tax Resolution, Ending Farm Crisis

Summary

1. (SBU) Late July 18, the GoA repealed the March 11 decree that set off the 129-day battle with the rural sector by imposing sliding scale export taxes on grains and oilseeds exports. This decision, which follows the Argentine Senate's July 17 failure to pass the resolution into law, returns export taxes to their previous levels and has been widely welcomed by agricultural and opposition leaders.

The immediate economic impact will likely be a surge of up to \$3 billion in exports of hoarded grains and soybeans. The fiscal impact of the decision is less clear, but the GoA will likely lose in the range of \$2 billion in potential 2008 revenues. Markets have reacted positively, albeit cautiously, to the decision. While the Senate vote and repeal of the March decree are clear victories for the agricultural sector, there is still a great level of uncertainty over how the GoA will react. Will it try to win approval for a new tax package? Will it reinitiate dialogue with the agricultural sector as its leaders are calling for? Right now, the government is probably still regrouping. But the widespread feeling in the country seems to be that democracy is at work in ways not seen in the memory of most Argentines. End Summary.

2. (SBU) Argentine Chief of Cabinet Alberto Fernandez announced this afternoon the repeal of the Economy Ministry's Resolution 125, imposed March 11, which established sliding scale export taxes on grains and oilseeds exports and provoked a 129-day farm strike that hollowed out support for the Kirchner administration and accelerated the deterioration of the Argentine economy. This decision, to be published July 21 as Decree 1176, follows the dramatic July 17 vote in the Senate to reject the government's bill that would have sanctioned the March Resolution (Reftel). In announcing the decision, Fernandez emphasized the government's respect for institutions and said the repeal would allow the continuation of discussions over export taxes in a more pressure-free and "democratic" atmosphere.

3. (SBU) Decree 1176 repeals Resolution 125/2008 and the resolutions that later modified it and returns export taxes from their current levels (e.g., 45 - 50% for soybeans) to their previous fixed levels prior to March 11 (Soybeans 35%; Soybean oil 32%; Soybean meal 32%; Sunflower seed 32%; Sunflower oil 30%; Sunflower meal 30%; Corn 25%; and Wheat 28%). Although this is a definitive victory for the agricultural sector and should bring an end to the chronic protests, there are numerous other agricultural sector complaints that the GoA has yet to address, including tight control of the export registration process and outright export bans on products such as beef and milk.

4. (U) PUBLIC REACTION: Agricultural leaders welcomed the revocation of Resolution 125. Luciano Miguens, head of the

Argentine Rural Society (SRA) termed it "extremely positive" and called on the GOA to engage in a "real dialogue" with the agricultural sector. Eduardo Buzzi, head of the Argentine Agrarian Federation (FAA) welcomed the announcement but called on the GOA to lower the export levies for small and medium producers to the 20-25% range, and he urged rapid consideration and approval of new legislation for leaseholders. Other farmers called for discussion of broader agricultural policies to support the farming sector. The political opposition applauded the end of Resolution as "late but welcome," many of them lamenting the four months it took to resolve the conflict. Elisa Carrio, the leader of the Civic Coalition (CC) who finished second in the October 2007 presidential election, thought the President's reversal was "very good since it will resolve the conflict, and it allows society and the government to take up the long-delayed agenda of how to deal with inflation, the energy situation and the plight of retirees." Leader of the Radical Party (UCR) Gerardo Morales said the GOA had no choice but to strike down Resolution 125 and called for a new, broader agricultural policy. Mauricio Macri, mayor of Buenos Aires and leader of the center-right opposition (PRO), welcomed the GOA's announcement but called on it to establish a dialogue with the agricultural sector.

15. (SBU) ECONOMIC IMPACT: The early impact will likely be an initial surge in exports of hoarded grains and soybeans, which private analysts estimate at as much as \$3 billion in total sales. This will provide a liquidity boost to the economy, with the Argentine Central Bank likely reverting to its pre-crisis position of purchasing incoming foreign currency on the spot market to maintain a stable exchange rate. This should result in lower domestic interest rates and a reversal of the capital flight of recent months, which in turn should slow the deceleration of the economy and lower high levels of uncertainty that have led to deposit withdrawals and the stagnation of investment. Argentine Central Bank officials privately estimate total potential exports pending resolution of the farm strikes of \$8-10 billion, and it has quietly sought assistance from banks and pension funds to help purchase the incoming foreign exchange. In the short term, at least, the peso should remain relatively strong, near the current level of 3 pesos/USD.

16. (SBU) FISCAL IMPACT: Also unclear is the possible fiscal impact of this decision. At today's world prices, the annual revenue from the now repealed GoA increase in the export taxes would have been in the broad range of \$2.5 to \$3.5 billion. Subtracting the roughly \$1 billion in subsidies and other forms of compensation plans the GoA has developed to appease smaller farmers, the result is that the GoA will lose in the approximate range of \$2 billion in potential 2008 revenues by repealing the tax. Many local analysts are concerned that the reduced revenues will lead to a deterioration of the GoA's fiscal balance if the GoA either does not reduce the pace of expenditure growth (currently running at about 40% per year) or is unable to find alternative sources of funding. This in turn could exacerbate inflation, which aside from the farm strike has been the other main source of instability in the Argentine economy this year.

17. (SBU) MARKET REACTION: Markets have reacted positively, albeit cautiously, to the Senate vote and today's decision to repeal the March Resolution. The Argentine stock market has increased 1.3% since the Senate vote, and bond prices have increased in the 2-4% range, depending on the instrument. Argentine risk levels, as measured by the 10-year Credit Default Swap (CDS) and sovereign risk premium (JP Morgan's Emerging Market Bond Index - EMBI), have fallen significantly. After hitting a post-default high of 806 basis points on July 14, the 10-year CDS fell to 718 basis points by close of markets on July 18. Likewise, the EMBI country risk measure for Argentina fell to 598 at markets' close July 18, after hitting 668 bps on July 15, the highest level since the GoA's 2005 debt restructuring. Nevertheless, there is clearly a wait-and-see mentality, and few investors seem to be ready to allocate capital to Argentina before it becomes fully clear how the GoA will react to its Senate defeat.

Comment

18. (SBU) The combination of the Senate rejection and the GoA's repeal of the March decree is a clear victory for the Argentine agricultural sector, and sure to have a short-term positive effect

in the form of increased exports of agricultural commodities. However, there is still a great level of uncertainty over how the GoA will react, and also over what medium-term impact this decision will have on GoA finances and the economy. There is an opening for the GoA to take a more accommodating stance, working with the farmers and Congress to fashion a more acceptable export tax regime. Nevertheless, given President Cristina Fernandez de Kirchner's low approval ratings, she is likely feeling pressure to increase spending to consolidate support among low-income voters and rebuild support in the middle class. The open question is whether to fund this increased spending the Kirchners will look to re-impose the higher export taxes via another potentially damaging battle in Congress, thereby kicking off the next chapter in the battle with the agricultural sector, or will try to put together some alternative income package.

¶9. (SBU) The GOA's revocation of Resolution 125 or its timing was not a sure thing, so the announcement made by Cabinet Chief Alberto Fernandez was a welcome relief (after a day of complete silence from Casa Rosada on the Senate vote) as it instantly calmed the public by suggesting the Kirchner administration may take the high road in moving past this conflict. The conflict with the "campo" has been a watershed for the Kirchners, and the staggering setback in the Senate may be the opportunity for Cristina Kirchner to re-launch or re-invent her government. Like the rest of Argentina, CFK and her inner circle may still be absorbing the implications of the political dynamics unleashed by the government's 129-day confrontation with the agricultural sector.

¶10. (SBU) On the broader scale, we have run into numerous Argentines whose eyes well up with tears as they recount the events of this week and how for the first time in their memory the Congress has seriously debated such a vital topic. There is a clear feeling of pride and hope that perhaps a new quality of democracy can emerge from this tumultuous series of events.
WAYNE